Service Date: June 8 , 1999

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Investigation of the Sale and Transfer of PacifiCorp's Distribution System and Public Utility Obligations to Flathead Electric Cooperative, Inc.	))))	UTILITY DIVISION DOCKET NO. D98.10.218 ORDER NO. 6103d

FINAL ORDER APPROVING RECOMMENDED ALLOCATION OF NET GAIN

1. On November 2, 1998, the Montana Public Service Commission (Commission) issued Order No. 6103a, approving the terms and conditions of the sale of the distribution facilities of PacifiCorp to Flathead Electric Cooperative, Inc. At its work session on October 30, 1998, the Commission had determined that PacifiCorp was to return $4 million of the net gain on the sale to ratepayers after a later proceeding to determine the means of distributing the gain. Subsequently, the Commission accepted the recommendation of Montana Consumer Counsel (MCC) to allocate $1.25 million to system improvements in urban areas and $2.75 to PacifiCorp's residential and small commercial customers in PacifiCorp's former territory. The Commission incorporated this allocation in Order No. 6103a, Findings of Fact Nos. 34-35.

2. On November 12, 1998, Plum Creek Timber Company, L.P., (Plum Creek) and Flathead Electric's regulated affiliate Energy Northwest, Inc. (ENI) filed motions for reconsideration of Findings of Fact Nos. 34-35 in Order No. 6103a on the issue of determining the allocation of the net gain in PacifiCorp's service territory. The Department of Environmental Quality filed a brief supporting these motions for reconsideration on November 24, 1998.

3. On December 1, 1998, MCC and Plum Creek filed a Stipulation and Joint Recommendation, proposing that the Commission allocate $1.25 million to distribution system improvements in **all** of PacifiCorp's service territory, not just the urban areas, and $2.75 million to direct payments to PacifiCorp's former customers. Of the $2.75 million, the recommendation would allocate $0.30 million to large general service customers served under Schedule 48T and apportion the remaining $2.45 million among the residential and commercial customers and loads served under other sched-

ules before July 1, 1998. MCC and Plum Creek proposed that the Commission conduct a further proceeding to address appropriate system improvements. On December 1, 1998, MCC also filed a response to the motions for reconsideration, recommending that the Commission deny the motions and approve the Stipulation and Joint Recommendation.

4. On December 11, 1998, Warren McConkey, general manager of Flathead Electric Cooperative (FEC) and Energy Northwest Inc. (ENI), filed an affidavit in support of a Motion for Reconsideration. Mr. McConkey attested that all former PacifiCorp customers should be treated fairly and equitably; FEC and ENI believed this would be best accomplished by allocating the $4 million to system improvements in the acquired service territory. FEC recognized Plum Creek's need to be treated the same as other former PacifiCorp customers in the event a rebate, rather than system improvements, were ordered.

5. The Commission approved Order No. 6103b in Docket No. D98.10.218 on December 15, 1998, granting the Motions for Reconsideration to the extent of establishing a contested case proceeding within this Docket to determine the allocation of the $4 million net gain. Because of this decision, the Commission did not approve the stipulation and joint recommendation filed by Plum Creek and MCC. The Commission directed its staff to convene a procedural conference, establish a procedural schedule and set a hearing date. On January 5, 1999, the Commission issued Procedural Order No. 6103c, setting the hearing date for May 13, 1999, with a schedule for prefiled testimony and discovery.

6. On March 15, 1998, John Goroski filed testimony on behalf of ENI, with three attachments: (a) Exhibit A, “Prefiled Recommendation of Energy Northwest, Inc.”; (b) Exhibit A-1, a list of $9 million in necessary reliability projects in the acquired area; and (c) Exhibit A-2, an economic analysis that shows acquired customers would benefit more from system improvements than from direct refunds.

7. Mr. Goroski addressed the issue of capital credits in his testimony. He outlined three problems with the position that the gain on the sale of the former PacifiCorp assets belongs to the customers who paid for the system, which can be recognized through assigning capital credits to them. First, under Montana law and FEC’s bylaws, capital credits must arise from a cooperative’s revenue and be allocated according to the patronage, or use, of the cooperative by the member. Allocation of a portion of the cooperative’s capital to a group of members would be inconsistent with

Montana law. Second, even if allowed, allocating $4 million of capital credits to the acquired customers while borrowing an additional $4 million for capitalized system improvements would create a windfall to the acquired members by doubling the capital allocable to them. Third, the equity problems and administrative costs associated with calculating capital credits are the same problems and costs associated with developing an equitable direct refunding mechanism.

8. In its prefiled testimony, Exhibit A, ENI recommended that the Commission allocate the $4 million of net gain to system improvements in the acquired area. ENI made the following representations: (a) the $4 million would allow faster implementation of the much needed $9 million worth of reliability projects in the acquired area; (b) acquired PacifiCorp customers would benefit more from system improvements than direct refunds as shown in Exhibit A-2; (c) system improvements would avoid inequity issues associated with direct refunds; and (d) system improvements would provide long-term benefits to both acquired and former cooperative members.

9. On April 15, 1999, ENI, FEC, Plum Creek and DEQ filed a joint recommendation on the disposition of the $4 million net gain. The parties recognized the sound policy of returning sale proceeds above net book value to customers. However, in this case the parties expressed significant concerns about the current and future system reliability of the acquired distribution system, based on representations and information from FEC as to the serious potential for system failures throughout the acquired service area.

10. The parties recommended as reasonable and equitable to the former PacifiCorp customers acquired by FEC and ENI that the Commission allocate the $4 million toward the prompt completion of necessary system improvements described in Exhibit A-1, direct testimony of John Goroski. The parties agreed that FEC and ENI should report to the Commission on a quarterly basis on the use of funds and on progress towards completion of the proposed system improvements. The parties made these recommendations recognizing the unique characteristics of the sale of PacifiCorp's Montana distribution system and the PacifiCorp service territory acquired by FEC and ENI. They asserted that, by making these recommendations, they did not establish any precedent or prejudice their rights in any future proceedings involving other transactions.

11. On April 16, 1999, the MCC filed the testimony of Frank E. Buckley. MCC accepted FEC's judgment that system improvements are required, deferring to the Commission's review of the record in that regard. Mr. Buckley noted that one of the three scenarios presented in Exhibit A-2

of Mr. Goroski's prefiled testimony indicated that it is least costly or in the consumers' best interest to have a direct refund. Assuming that refunds to residential customers would not be taxable and that O&M outage costs are already reflected in current rates, then two out of the three scenarios would indicate that the better alternative is a direct refund. Based on these comments, MCC still feels that the original allocation of gain was reasonable. However, MCC does not oppose the joint recommendation supporting use of the entire gain for system improvements.

12. On April 16, 1999, DEQ filed the testimony of Larry Nordell, who supported the joint recommendation. DEQ strongly supports the principle that above-book proceeds from the sale or transfer of regulated property belong to the customers who paid for the assets through their rates. This principle flows directly from the nature of utility regulation and the allocation of risk between the regulated utility and ratepayers. Application of this principle is consistent with the expectations of investors when they make investments in regulated property, as well as with those purchasers of regulated property when they seek to recover their costs, and consumers when they pay their utility bills. However, under the unique circumstances in this case, it is appropriate to weigh this principle against other issues substantially affecting the reliability of the service customers receive from the utility system.

13. FEC has acquired a large customer base, along with the distribution system necessary to serve this new load. According to FEC, the distribution system is in serious need of repair, and system reliability for the acquired customers is currently impaired. Many of the necessary improvements were identified by PacifiCorp but were deferred or otherwise not implemented. FEC asserts that its acquired customers currently experience excessive outages and poor reliability and that the system would be unable to perform adequately in severe winter conditions. For example, reconnecting customers after a prolonged winter outage would be difficult and customers would have to be phased in gradually to allow loads to stabilize. Further, frequent outages impose excessive repair costs on the system and on its customers. The Commission had previously worked with PacifiCorp and its customers on a number of system improvements.

14. DEQ urged the Commission to accept the joint recommendation and allow FEC and ENI to use the $4 million in above-book proceeds toward needed system improvements. Such improvements should be made where most needed, anywhere in the acquired territory and not limited to urban areas.

15. On May 12, 1999, the Commission held a public hearing in Kalispell, Montana to review the joint agreement and the disposition of the $4 million in above-book proceeds. John Goroski testified for ENI, stating that making the identified system improvements would provide the greatest benefits, in his analysis. On behalf of MCC Frank Buckley testified that the recommended allocation would benefit the ratepayers, and MCC did not oppose it. Members of the public testified on the record in support of allocating the gain to system improvements throughout PacifiCorp's acquired service territory. One person testified that making direct refunds would not be cost-effective. One customer sent a letter opposing the stipulation. Plum Creek and DEQ were excused from attending the hearing.

Commission Decision

16. The Commission determines, after a careful review of the record in this Docket, that the entire $4 million from the gain on the sale should be applied to system improvements described in Exhibit A-1 to the direct testimony of John Goroski, as recommended by ENI, FEC, Plum Creek and DEQ in their joint recommendation filed April 15, 1998. FEC and ENI have demonstrated that there are serious reliability concerns in the service territory acquired from PacifiCorp. By approving the allocation of the entire $4 million to system improvements, the Commission determines that customers of FEC and ENI should receive long-term benefits through improved system reliability. None of the $4 million in system improvements will be included in rate base or recovered in rates from PacifiCorp's former customers.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission regulates the rates and services of public utilities pursuant to Title 69, Chapter 3, Montana Code Annotated (MCA). . 69-3-102, MCA.

2. ENI is a public utility subject to the jurisdiction of the Commission. § 69-3-101, MCA.

3. The Commission has the power to prescribe rules of procedure and to do all things necessary and convenient in exercising its powers, including the power to regulate the mode and manner of all investigations and hearings under Title 69, Chapter 3, MCA. § 69-3-103, MCA.

4. Pursuant to its general authority in regulating public utilities, the Commission has properly exercised authority over PacifiCorp's sale of public utility property to Flathead Electric Coop-

erative, Inc., and its regulated affiliate, ENI. With the jurisdiction over sales and transfers of public utility property, the Commission has the authority to determine the allocation and distribution of a net gain on the sale. (Order No. 6103a, Order Approving Sale, issued November 2, 1998).

5. The Commission has properly noticed this proceeding and given the public and the parties ample opportunity to participate, pursuant to the contested case procedures of the Montana Administrative Procedures Act (MAPA), Title 2, Chapter 4, MCA.

ORDER

WHEREFORE, THE COMMISSION ISSUES THE FOLLOWING ORDER:

1. The Commission hereby approves the dedication of the entire $4 million of above book proceeds to system improvements most needed anywhere in the acquired territory. This does not constitute pre-approval of these system improvements. The improvements must be completed on a timely basis, not later than two years from the date of this order.

2. This Order does not constitute precedent on the disposition of proceeds above book value on the sale or transfer of utility assets. This case was decided on factors that are unique to the service territory acquired from PacifiCorp.

3. FEC and ENI shall file reports to the Commission on a quarterly basis detailing the use of the funds and the progress toward completion of the proposed system improvements. The first quarterly report will be due on July 15, 1999, and will cover the quarter ending June 1999.

4. None of the $4 million in system improvements approved in this Order may be added to rate base or recovered from PacifiCorp’s former customers.

DONE AND DATED this day of June 8, 1998 by a vote of 5 -0 .

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DAVE FISHER, Chairman

NANCY MCCAFFREE, Vice Chair

BOB ANDERSON, Commissioner

GARY FELAND, Commissioner

BOB ROWE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.